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In the Supreme Court of the United States

OCTOBER TERM, 1995

NORWEST CORPORATION AND AFFILIATED COMPANIES,
PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

REPLY BRIEF FOR PETITIONERS

TIMOTHY S. BISHOP
Counsel of Record
JOEL V. WILLIAMSON
THOMAS C. DURHAM
ROGER J. JONES
TRACY M. FLYNN
Mayer, Brown & Platt
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

Counsel for Petitioners

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REPLY BRIEF FOR PETITIONERS

In its petition, Norwest showed that the Eighth Circuit's decision in this case is diametrically opposed to the decisions of the Court of Claims in the *Mexican Railroad Cases*, that the Commissioner's expansive interpretation of the Temporary Treasury Regulation to deny Norwest foreign tax credits is inconsistent with IRC § 901, and that the issues presented for review are of tremendous importance to lenders to Brazil who have some $300 million in foreign tax credits at stake. The Commissioner has failed to explain why this Court's intervention is not required to settle this conflict and correct the Eighth Circuit's error of law.

1. The Commissioner acknowledges that the tax court has "expressly declined to follow the Mexican railroad car cases." Br. in Opp. 13. She urges that despite this explicit rejection of the Court of Claims' holdings and despite the totally opposite results below and in the *Mexican Railroad Cases*, there is no "conflict" requiring this Court's attention. This, she claims, is because the Eighth Circuit rested its decision on Temporary Treasury Regulation § 4.901-2(f)(3), which was not in effect at the time of the *Mexican Railroad Cases*. *Id.* at 14. The Commissioner's attempt to avoid the obvious conflict in the lower courts is to no avail, for as we demonstrated in our petition (at 14-18), the temporary regulation, as expansively interpreted by the Commissioner, was *invalid*. Indeed, the *Mexican Railroad Cases*, which interpreted Section 901, demonstrate beyond question that the Commissioner's interpretation of the regulation to preclude foreign tax credits in this case is inconsistent with the statute.

Moreover, the Commissioner's quibble that there is no true conflict because the cases deal with the U.S. tax consequences of different tax systems—one imposed by Brazil, the other by Mexico—is unavailing. Both this case and the *Mexican Railroad Cases* decided the same issue—whether a taxpayer is entitled to a credit for foreign income taxes insofar as the foreign government provided a subsidy

in an amount based upon the tax—with conflicting results. The Court of Claims held that the Mexican government's grant of subsidies to the Mexican railroads was "wholly an internal Mexican affair that is of no concern to us." *Chicago, B. & Q. R.R.*, 455 F.2d at 1023; see Pet. 10-12. In contrast, the Eighth Circuit was very concerned about the Brazilian government's grant of subsidies to Brazilian borrowers—indeed, this "internal" matter was held determinative of U.S. tax consequences. It is undeniable that this case and the *Mexican Railroad Cases* concern the same issue and reach completely opposite outcomes.[1]

2. The Commissioner makes two arguments to support her position that the Temporary Treasury Regulation bars a foreign tax credit in the circumstances of this case. First, she asserts, it is a valid exercise of her power to interpret the tax laws to which the courts owe deference. Second, as the Seventh Circuit reasoned in *Continental Illinois*, 998 F.2d at 519-520, and the Eighth Circuit held here (Pet. App. 8a-9a & n.4), the temporary regulation supplies a bright line that avoids the difficulty of determining who actually reaps the economic benefits of a tax subsidy. Neither argument has any merit.

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[1] The Commissioner's efforts to distinguish *Hillsboro*, 460 U.S. 370, are equally misplaced. The issue in *Hillsboro* was whether a bank, which had paid state taxes imposed on its shareholders and properly deducted the payments, was required to recognize as income the taxes later refunded to the shareholders. This Court reasoned that because the bank and shareholders were "independent of one another," the bank's tax payment was "not negated by a refund" to the shareholders. *Id.* at 394; see Pet. 13. Not only does *Hillsboro* therefore have a "logical relationship" to this case (Br. in Opp. 15-16), because it addresses the effect of a refund in analogous circumstances, but the Eighth Circuit's holding is squarely at odds with the principles enunciated in *Hillsboro*.

While the Commissioner emphasizes the deference owed her interpretations of the tax laws as well as her prerogative to revise her position when she deems it appropriate (Br. in Opp. 7-8, 11-12), she fails to acknowledge that different levels of deference are appropriate in different circumstances. As we showed in our petition (at 16-18), the Commissioner is owed substantially less deference when her position has been inconsistent over the years, as it was here. *Albright*, 173 F.2d at 344-345. And she is owed substantially less deference when her interpretation was not contemporaneous with passage of the statute. *Rowan*, 452 U.S. at 253. Here, her revisionist interpretation came many years after the passage of IRC § 901. Most importantly, the Commissioner is entitled to *no* deference where, as in this case, her position is a "litigating position" that is inconsistent with prior "administrative practice." *Bowen*, 488 U.S. at 212; see Pet. 17-18 (citing authority).

This case shows that the Commissioner's bright line test is unnecessary—or at least overbroad. The Commissioner has admitted that the refund provided no economic benefit to Norwest, but that its implementation left U.S. lenders in "exactly the same" position. Pet. 14. Moreover, Brazil's Finance Minister explained that the purpose of the refund program was to stimulate foreign borrowing to alleviate domestic problems, and had nothing to do with benefitting foreign lenders. *Id.* at 5. The entire premise of the Commissioner's interpretation of her regulation, that there would be factual difficulties in determining whether the lender received an economic benefit, simply does not apply to the Brazilian loans.

In any event, the Commissioner may not promulgate a regulation in conflict with the plain language and policy of the controlling statute. As we demonstrated in our petition (at 14-18), Section 901's provision for credits for taxes "paid or accrued" allows the Commissioner to deny credits only

where a subsidy provides an economic benefit to the U.S. taxpayer—something that the Commissioner herself recognized in revenue rulings and private letter rulings predating the temporary regulation. See Pet. 15-16. The Commissioner fails even to acknowledge the primary purpose of Section 901—the avoidance of double taxation. That purpose mandates an "economic benefit" rule for determining the U.S. tax consequences of subsidies to foreign borrowers.[2]

3. Respondent repeatedly points out that Congress codified the regulation "for all years after 1986" (*e.g.*, Br. in Opp. 6, 12 n.3, 16), as if this change made the issues in Norwest's petition unimportant. But the Commissioner does not deny that over $300 million in foreign tax credits from billions of dollars in loans made before 1986 are at stake here. The Commissioner should not be heard to assert that the tax treatment of those loans is unimportant, and the substantial tax question presented unworthy of resolution. While Congress codified the regulation for loans made after 1986, our petition presents economically very significant issues for the many businesses that made loans before 1986.[3]

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[2] The Commissioner argues that the denial of foreign tax credits is particularly appropriate for net loans, the type of loan at issue here. Br. in Opp. 10. But all that distinguishes net loans from gross loans is who physically remits the lender's income taxes to the foreign government—the borrower in net loans, and the lender in gross loans. A lender presumably takes into account the expected foreign tax credits when fixing the interest rates of both net and gross loans. Who physically remits the tax is inconsequential to the issue of whether the lender "pays" the tax. See C.A. Br. 4-5.

[3] The Commissioner places heavy reliance on Congress's statement that the enactment of IRC § 901(i) and the promulgation of new regulations under the statute should not be taken to reflect on the validity of the Commissioner's position on the meaning of

The inequity of arguing that review should be denied because of changes made in 1986 is also obvious. When Norwest made the loans in issue, lenders to Brazil relied on revenue rulings, private letter rulings, and the holdings of the *Mexican Railroad Cases*,[4] which all indicated that foreign tax credits *were* available.

4. The Commissioner buries the important issue of Resolution 63, or repass, loans in a footnote. This is hardly surprising, for she invents an entirely new legal standard for assessing such loans. Br. in Opp. 10-11 n.2. Ignoring the requirement of Temp. Treas. Reg. § 4.901-2(f)(3)(ii)(B) that only a subsidy to an entity engaged in a "business transaction" with a lender may be considered a subsidy to that lender, the Commissioner substitutes a much weaker standard, holding that there is a subsidy to the lender whenever it has a "business connection" with the direct recipient of the subsidy. The Commissioner then asserts that Norwest and the repass borrowers meet this watered-down "business connection" standard—a standard so expansive and all-encompassing that it would be difficult *not* to meet given the interconnectedness of the modern business world. *Ibid.*

This tactic is transparent, and clearly illegitimate. The plain language of the temporary regulation requires that the parties engage in a "business transaction," not that the parties have some sort of vague "business connection." The

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the earlier statute. Br. in Opp. 12 n.3. We specifically addressed this point in our petition, citing cases in which courts have held that prospective amendments changed the law where Congress purported merely to clarify it. Pet. 16 n.2.

[4] Thus, petitioners did not improperly rely solely on private letter rulings, as the Commissioner suggests. Br. in Opp. 11. Those rulings were mirrored by the 1957 revenue ruling (see Pet. 15) and the *Mexican Railroad Cases*.

history of the regulation, too, demonstrates that it contemplates some actual business relationship between the borrower and the lender. In 1979, the Commissioner rejected proposed regulations that would have precluded a foreign tax credit in the amount of a subsidy whenever the borrower was engaged "directly *or indirectly* in a business transaction" with the lender in favor of the more restrictive "business transaction" language. C.A. App. No. 78 (emphasis added). While the Commissioner champions the temporary regulation when it suits her needs, she toys with its plain language when it does not.

The "business connection" standard now advanced by the Commissioner is an expedient response to the facts presented below, which demonstrate that Norwest and the repass borrowers engaged in no "business transaction." The court of appeals acknowledged as much when it found that in the case of Resolution 63 loans, the transaction between the foreign lender and the borrowing bank was "separate from the transactio[n]" between the borrowing bank and the repass borrower. Pet. App. at 11a. Moreover, Norwest and the repass borrowers could not possibly have engaged in a "business transaction" with each other as required by the temporary regulation, for it is undisputed that Norwest *did not even know the identity* of the repass borrowers. Pet. 3.

In summary, the Commissioner has failed to rebut Norwest's detailed showing in its petition that the lower courts are in conflict on economically important tax issues that require this Court's attention.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

TIMOTHY S. BISHOP
Counsel of Record
JOEL V. WILLIAMSON
THOMAS C. DURHAM
ROGER J. JONES
TRACY M. FLYNN
Mayer, Brown & Platt
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

Counsel for Petitioners

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